

1978

Melinda Rudd, Administratrix of The Estate of Hy Rudd v. Mel Parks : Brief of Defendant-Appellant

Utah Supreme Court

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IN THE SUPREME COURT
OF THE STATE OF UTAH

MELINDA RUDD, Administratrix of	:	
the Estate of Hy Rudd,	:	
	:	
Plaintiff and Respondent,	:	
	:	
v.	:	Case No. 15491
	:	
MEL PARKS,	:	
	:	
Defendant and Appellant.	:	

BRIEF OF DEFENDANT-APPELLANT

* * * * *

Appeal from the Judgment of the Third
Judicial District Court in and for
Salt Lake County, Utah
Honorable Maurice Harding, Judge

* * * * *

CRIDDLE, THORPE & WESTERN
Vaughn W. North
10 West First South, Suite 700
Salt Lake City, Utah 84101
Telephone: 364-6447
Attorneys for Defendant-
Appellant

Bernard L. Rose
Irving H. Biele
920 Boston Building
Salt Lake City, Utah 84111
Telephone: 532-2666
Attorneys for Plaintiff-
Respondent

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Clerk, Supreme Court, Utah

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CRIDDLE, THORPE & WESTERN
Vaughn W. North
10 West First South, Suite 700
Salt Lake City, Utah 84101
Telephone: 364-6447
Attorneys for Defendant-
Appellant

Bernard L. Rose
Irving H. Biele
920 Boston Building
Salt Lake City, Utah 84111
Telephone: 532-2666
Attorneys for Plaintiff-
Respondent

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NATURE OF CASE

This is a contract action commenced by Melinda Rudd, Administratrix of the Estate of Hyman Rudd, against Mel Parks, purchaser of Hyman Rudd's business, for collection of payments accruing after Hyman Rudd's death and payable in accordance with the provisions of a Covenant Not to Compete executed in connection with the sale of Mr. Rudd's business to Defendant.

DISPOSITION IN LOWER COURT

The District Court for Salt Lake County held that the death of Hyman Rudd did not terminate the obligation of Mel Parks to make payments under the subject Covenant Not to Compete, in a judgment made and entered on the 23rd day of September, 1977.

NATURE OF RELIEF SOUGHT ON APPEAL

Defendant-Appellant seeks to have the judgment reversed, with instructions to the District Court to enter judgment dismissing Plaintiff's action. Alternatively, Defendant requests remand to the trial court to determine the amount of consideration to be attributed to the Covenant Not to Compete, including that part to be forfeited after the death of Hyman Rudd.

STATEMENT OF FACTS

Melinda Rudd is the daughter of Hyman Rudd who died in October of 1975. She was appointed as Administratrix of the Estate of Hyman Rudd on December 12, 1975. Prior to October, 1973, Hyman Rudd had worked in the waste and refuse

collection business, under the name of Salt Lake Sanitation, of which he was the sole owner. Mr. Rudd had conducted his business in the Salt Lake area for many years and was well acquainted with the many competing companies and their personnel. He was also an active member of the Utah Trash Handler's Association.

Defendant Mel Parks is a resident of Boise, Idaho, and has also been associated with the trash collection industry in Idaho for many years (Tr. page 15, line 27)¹. During this career in the trash collection industry, Mel Parks had previously made purchases of such businesses (Tr. page 16, line 1-3).

On January 26, 1973, Hyman Rudd made a visit to his doctor complaining of chest pains, and was diagnosed as having had a heart attack. Sometime thereafter, Mel Parks was contacted by Hynda Rudd, the wife of Hyman Rudd and advised that he had had a heart attack and wanted to sell the business (Tr. pages 5-10). Several weeks later, Mel Parks visited Salt Lake City and talked to Mr. Rudd about the purchase of his business. After considerable negotiation, Mr. Parks instructed Jesse Walters, his attorney, to send Mr. Rudd a letter making a formal offer to purchase the business, stipulated on separate allocations of consideration for the sale of equipment, the sale of customer accounts and goodwill, and a covenant not to compete (Tr. page 17, line 26). This offer was discussed and negotiations continued until tentative terms were acknowledged as acceptable.

¹Since the proceedings at the District Court were conducted in accordance with a pre-trial order dated June 23, 1977, and signed by the Honorable Earl Baldwin, Jr., much of the fact summary is based on that source. Citations in support of such facts have not been included in view of the stipulated facts of the pre-trial order. Any facts not specifically recited in the subject trial order have been appropriately identified by cross references to the trial record.

by the parties in September, 1973.

Upon obtaining a tentative agreement, Mel Parks instructed his attorney, Jesse Walters, to prepare documents to effect the sale and purchase of Salt Lake Sanitation. These documents consisted of (1) Agreement to Sell and Purchase Equipment, (2) Agreement to Sell and Purchase Customer Accounts and Goodwill, and (3) Covenant Not to Compete. Both Parks and Rudd were advised by their respective accountants, Ray Carter and Dexter Snow, as to the tax aspects of these agreements. Rudd was specifically advised by Snow as to the adverse tax effects of the Covenant Not to Compete, to the effect that such payments would be taxed as ordinary income and not capital gains. It was Hyman Rudd's determination that such terms were acceptable in order to effect the sale of the business and were the only terms on which Mel Parks would buy Salt Lake Sanitation.

The three stated agreements were signed by Mel Parks in Idaho and then by Hyman Rudd in Utah. The terms of the Agreement to Sell and Purchase Equipment (Exhibit 3-P), and the Agreement to Sell and Purchase Customer Accounts and Goodwill (Exhibit 2-P) were fully performed by both parties. The first of these agreements conveyed equipment to Mel Parks for a total consideration of \$83,000. The agreed form of payment was that Mel Parks would assume outstanding debts owed by Rudd totaling \$82,613.88, and would pay the difference of \$386.12 in cash. The second agreement transferred customer accounts and goodwill to Parks in exchange for a \$15,000 cash payment.

The third agreement was a Covenant Not to Compete operable over a period of five years. The consideration to be paid by Parks for the forbearance of Hyman Rudd under this Covenant Not to Compete consisted of "the sum of \$95,000, payable

as follows: the sum of \$6,500 on January 20, 1974, and the sum of \$1,500 per month on the 20th day of each month thereafter until December 20, 1978. . . " Mel Parks faithfully performed his payment obligations under this agreement until the death of Hyman Rudd in October, 1975, paying a total of \$36,000. Parks did not make further payments following Rudd's death.

During the performance period prior to the death of Hyman Rudd, no objections were raised by either party as to any term of the agreements. The only agreement in issue is the Covenant Not to Compete, that issue being raised by the Estate as to the continuation of payments after the death of Hyman Rudd. Mr. Parks asserts that the payment obligation under a Covenant Not to Compete terminates at the death of the noncompeting party. The Estate of Mr. Rudd claims a right to continued payments.

ARGUMENTS

The primary basis of error presented herein deals with the failure of the Trial Court to treat the subject Covenant Not to Compete as a restrictive covenant with the attendant legal limitations as to purpose and enforceability. Defendant submits that the Court, instead, viewed the Covenant as a means to sell the business, and not as an agreement having separate and distinct value aside from the conveyance of business assets. Defendant asserts that if the Court had treated the subject Covenant in accordance with the expressed intent of the parties to have a formal covenant not to compete, both law and equity would have resulted in a holding in favor of Defendant.

POINT I

EVIDENCE DOES NOT SUPPORT FINDING BY COURT THAT THE SALES TRANSACTION WAS MERELY "FORMALIZED BY USING THREE SEPARATE DOCUMENTS TO GIVE IT LEGAL EFFECT..." (Tr. page 120, line 1-2).

The clear implication of the trial court's finding as stated above is that the Covenant Not to Compete was an arbitrary allocation of a total sales price and therefore should not be the basis for avoiding full payment of the total sales price. This conclusion is contrary to the preponderance of evidence presented at trial, especially in light of Plaintiff's burden of proof. Defendant submits that the weight of evidence establishes that the Covenant Not to Compete was an essential part of the transaction and not the product of mere formalization.

It is admitted, for example, by stipulation in the pre-trial order (R. 139, paragraph 1) and by Plaintiff's Findings of Fact (No. 8, R-192) that the Agreement to Sell and Purchase Equipment and the Agreement to Sell and Purchase Customer Accounts and Goodwill "having been fully performed, present no problem in this cause, having been admitted to establish the entirety of the transaction, and the validity of the Non-Competition Covenant as ancillary to the sale of a business." If indeed the first two agreements have been fully performed and there are no problems with respect thereto, then the effect of these agreements should stand as written. This is true with respect to sufficiency of consideration inasmuch as Plaintiff has not placed any of the provisions of these two agreements in issue.

Inspection of the Agreement to Sell and Purchase Equipment shows that consideration of \$82,000 was paid by Mel Parks in return for equipment conveyed in connection with the purchase of the business. Plaintiff neither alleged nor proved that the \$82,000 payment was substantially below the market price of the

equipment, nor that the consideration was insufficient on any basis. Hyman signed the agreement, performed under the agreement, and made no objection to the terms of the agreement. Indeed, Plaintiff has confirmed that the agreement was performed in full and is not an issue, except to establish the entirety of the transaction.

Likewise with the Agreement to Sell and Purchase Customer Accounts and Goodwill, Plaintiff has confirmed full performance and satisfaction with the terms thereof. Plaintiff produced no evidence showing improper valuation of either customer accounts or goodwill, nor was such an issue raised during the proceedings.

Under the pre-trial order which governs the proceedings in trial, this same fact was specifically admitted, stating in Section III, para. K.:

"The terms of agreement i and ii have been fully performed by both parties. Exhibit i conveyed equipment to Parks for a total consideration of \$83,000---\$386.12 in cash to Rudd and the balance as assumption of outstanding debts owed by Rudd. Exhibit ii transferred customer accounts and goodwill to Parks in return for \$15,000 in cash."

If the effect of these agreements, having been fully performed, was to convey the business equipment, customer accounts and goodwill, then the clear implication is that there is no issue with respect to the sufficiency of consideration of the transferred items under the two agreements.

The Covenant Not to Compete, therefore, which was the only agreement in issue in this case, could not reasonably be construed to be consideration for the purchase of equipment, accounts and goodwill. Since these were the only assets of the business, the only item of value remaining in the transaction was to the forbearance from competition by Hyman Rudd, as was stated in the Covenant.

Not to Compete. This conclusion is specifically stated in the premises of the Covenant Not to Compete (Exhibit 1-P, line 13), "WHEREAS, the Seller has sold to Buyer, and the Buyer has purchased from Seller, the Salt Lake Sanitation, NOW THEREFORE..." (Emphasis added). It is apparent that the past tense expressed "has sold" and "has purchased" represents the clear intent of the parties that the Agreements to Sell and Purchase Equipment, and to Sell and Purchase Customer Accounts and Goodwill had, in fact, already transferred the business assets to Mel Parks before effecting the Covenant Not to Compete.

Since the first two agreements had in fact been fully performed as admitted by the Plaintiff and expressed by the "Whereas" clause in the Covenant Not to Compete, then the business assets were sold at such time of full performance of these respective first two agreements. It is therefore inconsistent to assert that payments due under the Covenant Not to Compete represent further consideration for the same purchase of business assets.

The evidence presented at trial supports the proposition that the Covenant Not to Compete was intentionally included in the transaction for the purpose of preserving the purchased business in the hands of Mel Parks and was therefore based on separate consideration. As stated previously, Hyman Rudd had a long association in the trash collection industry in the geographical area in which Park's newly acquired business would operate. The close business relationships developed by Hyman Rudd over this long period of time and his long standing association with the many competing trash hauling businesses in the area presented a serious threat to the value of the purchase made by Parks, unless such a Covenant

Not to Compete was placed in effect. Without such a covenant Hyman Rudd could take advantage of his long relationship with both customers and competing enterprises and virtually destroy Salt Lake Sanitation, along with any value acquired in the purchase transaction.

The fact that Mel Parks was a total stranger to the community, being a resident of Boise, Idaho, further emphasized the risk of such a purchase with the associated Covenant Not to Compete. It is well known, for example, that customers to a service related enterprise such as the trash collection industry place primary reliance on the management and not on the mere ownership of the business. Therefore the acquisition of Salt Lake Sanitation by Mel Parks, a man totally unknown to the former customers of Hyman Rudd, would represent little or no guarantee of future business with such customers. Hypothetically, Hyman Rudd could have acted in a consultant capacity to one or more competing trash hauling companies and utilized his personal influence with former customers to motivate a change of accounts away from Salt Lake Sanitation.

Having transacted other purchases of trash collection businesses (Tr. 16, line 10), Mel Parks appreciated the gravity of risk in coming into a new business and taking over an ongoing business. It was for this reason that the Covenant Not to Compete was included in the transaction. As stated in Mr. Park's testimony (Tr. page 30, line 9-18) and as stipulated in the admitted facts under the present order, Mr. Park's would not have purchased Salt Lake Sanitation, except for the inclusion of the Covenant Not to Compete.

The fact that all of the parties to this lawsuit acknowledge that Mel Parks would not have purchased the Salt Lake Sanitation business for the stated total

purchase price of \$192,000 is clear evidence showing the primary consideration basis of the Covenant Not to Compete. The failure of Plaintiff to negate this fact leaves little doubt that the Covenant Not to Compete was an integral element to the meeting of the minds on this sale of transaction, and not the result of mere formalization of a sale of business assets.

POINT II

THE TRANSFER OF SALT LAKE SANITATION BY MEANS OF THREE AGREEMENTS STATED IN TERMS OF A TOTAL SALES PRICE DOES NOT SUPPORT A CONCLUSION THAT THE AGREEMENTS COMPRISED A SINGLE CONTRACT WHOSE PAYMENT PROVISIONS ARE IMMUNE FROM THE INDIVIDUAL EFFECTS APPLYING TO EACH OF THE THREE AGREEMENTS.

In viewing the facts of the subject transaction, the Court should note the commercial realities which face parties involved in the sale of a sole proprietorship such as Salt Lake Sanitation. It has been held, for example, that where a sole proprietor sells his entire business, that business must be "commimuted into its fragments." William V. McGowen, 152 F2d 570 (2 Cir). Under the present law, the fragments consist of (1) goodwill which is a capital asset, (2) equipment and fixtures, and (3) merchandise, accounts, and notes receivable, which are ordinary assets. P-H Fed Tax 32,097 "Sale of entire business." Defendant asserts that this transfer was effected by the first two agreements previously discussed.

Frequently, such a sale of an entire business will not be of value unless the Buyer is able to protect himself against subsequent competitive acts of the Seller. The Covenant Not to Compete is usually included to give legal effect to such protection. It is well accepted law, however, that this "restrictive covenant must be incidental or ancillary to a valid contract of sale or other transfer of

property if it is to be enforceable." See 45 ALR 2d 77. It is not surprising, therefore, that many legal form books incorporate a Covenant Not to Compete paragraph into a single sales transaction agreement (Tr. page 100, lines 7-10). Furthermore, it is not uncommon for such a sales transaction agreement to specify a total sales price and then allocate the total sales price into its respective fragments of assets and also to a value for the Covenant Not to Compete. When an allocation of consideration is not made to the Covenant Not to Compete, the Courts have had occasion to assign a value to the Covenant Not to Compete based on the intent of the parties. In the tax case of Comm. v. Killian 314 F2d 852, (5 Cir., 1963) the Court stated:

"Whether any portion of the sales price should be attributed to a Covenant Not to Compete depends upon whether the parties treated the Covenant as a separate and distinct item and whether the purchasers actually paid anything for the Covenant as a separate item in the deal."

Both the evidence presented at trial and the express agreements of the parties support the proposition that not only was the subject Covenant Not to Compete treated separately, but that the Covenant Not to Compete was the basis of finalizing the agreement. As was admitted by the parties hereto that except for the Covenant Not to Compete with its accompanying restriction, Mel Parry would not have purchased the business. It is clear therefore that the Covenant Not to Compete was a separate and critical part of the sales transaction and should be considered as a separate aspect of consideration.

Plaintiff has not shown that the total sales price was determined with regard to a Covenant Not to Compete or that the Covenant was without independent

consideration from the business assets. Plaintiff has also failed to show that the covenant was not treated as a "separate and distinct item." Instead the testimony and documents show that the Covenant Not to Compete was a condition of the sale from the very outset of negotiations. The testimony of Parks was, "I agreed to buy the business stipulated on three separate contracts." (Tr. page 14, lines 15, 26.) The testimony of Mr. Walters, who drafted the agreements, was "I was instructed by Mr. Parks relative to the important terms of the Covenant Not to Compete, precisely, the financial amount and the location of the noncompete agreement as to what area it would cover." (Tr. page 93, lines 23-26.) His testimony further indicated that it was Mr. Park's instructions to effect the transaction by three separate agreements, and such decision was not his choice of drafting. (Tr. page 93, line 27.) The overall effect of the evidence as to the "separate and distinct" treatment of the Covenant Not to Compete is given by the trial court as follows:

"Isn't it quite evident that we all know that it (Covenant Not to Compete) was an integral part? It was an important part of the contract. You've got it here signed by both parties." (Tr. page 116, lines 27-30.)

It is therefore submitted that the three agreements forming the sales transaction, and particularly the Covenant Not to Compete, were not merely "formalized...to give it legal effect..."; but to the contrary, the Covenant Not to Compete had separate and independent meaning from the first two agreements effecting the sale of business assets.

For the Trial Court to state that the three agreements appeared to form "one entire transaction between Parks as the Buyer and Rudd as the Seller", does

not therefore resolve the issues of this case. As has been shown, virtually every sale of an on-going business with a Covenant Not to Compete will appear as "a transaction" because the restrictive covenant must be ancillary or incident to the sale. In the present case Parks did all he could to show separate and independent intent of the covenant. He directed his attorney to draft it as a separate agreement. He conditioned the sale on the execution of such a covenant and he extended the payment obligations of the covenant over a period of time consistent with the noncompetition obligation of Rudd.

POINT III

REFERENCE BY THE PARTIES TO A "TOTAL SALES PRICE" DOES NOT NEGATE THE INDEPENDENT VALUE AND LEGAL STATUS OF THE COVENANT NOT TO COMPETE.

During the course of the trial Mr. Parks indicated his expectation at the time of signing the subject agreements that \$192,000 would be paid to Rudd. The Court apparently determined from this expectation that the agreements represented an "entire transaction" totaling \$192,000, and that Parks should be required to pay this amount, based on this expectation. This conclusion, however, ignores the specific finding of fact that this expectation was founded on the state of mind of both parties would survive the contract period of five years. This finding was summarized by the trial Court during Defendant's hearing for Motion to Amend the Findings of Fact and Conclusions of Law, as follows:

Court: "I think at the time he (Parks) entered into the contract, he had no idea that either one of them was going to die. They didn't think about that matter. I don't believe they considered it at all. It isn't like a marriage covenant where they say, until death do you part. But I don't think they considered it. Just entered into the contract and it was a package deal and Mel Parks expected to pay the full amount of

consideration. They expected to get the property described and they expected to pay the performance of Hyman Rudd not to compete and the consideration was fully delivered so that he (Parks) owed the full amount of the money."

Mr. Parks confirmed this basis of expectation of payment by specific testimony indicating that his statements regarding full payment were based on assumption that Rudd would survive the contract period (Tr. page 118, line 10-12).

The fact that at the time of signing the agreements, Mel Parks expected to pay a total sum of \$192,000, does not imply the same conclusion with respect to payments pursuant to the event of premature death of Hyman Rudd. In the words of the Court, "they didn't think about that matter." Therefore, it is not surprising that Mr. Parks had the expectation of paying the full amount under the terms of the agreements. Furthermore, such an expectation is not determinative as to the continuation of payments in the event of death. Since the parties did not contemplate the effect of death, the Court should not base its holding on party intent which relied on survival.

It should be noted that we are dealing with a form of personal service contract, in which the death of the parties has profound legal effect. As was stated in Keller v. California Liquid Gas Corporation, 363 F. Supp 123 (1973), "Covenants Not to Compete have been held to be, by a majority of the courts, of a personal nature." Like any personal covenant, the parties typically expect the party to perform the services to survive the period of performance and therefore initially expect to pay the full amount of consideration bargained for under the personal covenant. Obviously, however, the court recognizes numerous situations in personal service contract law where the parties are not required to continue

payments under a change of circumstance such as death.

The stated conclusion of the Trial Court, therefore, regarding the expectation of Mel Parks to pay a total consideration of \$192,000 does not support the legal conclusion that such payments must continue despite changes of circumstance. This is true especially in view of the Court's specific holding that neither party was thinking of death at the time the agreement was entered, and therefore could not have had specific intentions that the contract operate after the death of Hymar.

POINT IV

THE TRIAL COURT FAILED TO TREAT THE COVENANT NOT TO COMPETE AS AN AGREEMENT SUPPORTED BY ITS OWN CONSIDERATION AND DID NOT THEREFORE APPLY THE LAW NORMALLY APPLIED TO SUCH RESTRICTIVE COVENANTS.

It is Defendant's position that the trial Court committed reversible error by dealing with the Covenant Not to Compete as a sales contract as opposed to its true character as a restrictive covenant. It is submitted that the previous decisions clearly demonstrate that the intent of the parties was that the Covenant Not to Compete was to be construed as a restrictive covenant and not as a sales agreement. The parties treated it as such, and the courts should do the same. Therefore, the primary issue of this case remains unresolved, to wit:

UNDER THE PROVISIONS OF A COVENANT NOT TO COMPETE ANCILLARY TO THE SALE OF A BUSINESS, WHAT OBLIGATION OF PAYMENT REMAINS UPON THE DEATH OF THE NONCOMPETING PARTY, WHERE THERE WAS NO EXPECTATION BY EITHER PARTY THAT DEATH WOULD OCCUR.

Defendant submits that there is a substantial body of law that has been developed on the subject of covenants not to compete, and that this law should have been applied.

applied to the present Covenant Not to Compete. The fact that the Trial Court viewed this law as "good authority" (Tr. page 120, line 12) for terminating the obligation of payment upon the death of Rudd and that this was a "very close case", but held to the contrary in view of the "entire transaction" basis, is strong grounds for reversal in view of the fallacious assumption that Park's expectation to pay the full amount applied equally in the event of death of a party.

POINT V

THE LAW DEVELOPED UNDER THE SUBJECT OF "AGREEMENTS IN RESTRAINT OF TRADE" ESTABLISHES SPECIFIC LIMITATIONS WITH RESPECT TO THE DURATION OF COVENANTS NOT TO COMPETE.

Once it has been determined that this third agreement (Plaintiff's Exhibit P-1) should be treated as a Covenant Not to Compete, its construction should proceed under the law and public policy considerations which have been developed by the courts with respect thereto. Such considerations form a unique body of law denominated under the category of "Agreements in Restraint of Trade." This law is considered unique because it defines the conditions which permit the enforcement of an otherwise unenforceable agreement. It is well known, for example, that agreements in restraint of trade are unenforceable as being against public policy. When an entire business is being sold, however, the counter consideration of protecting the newly acquired goodwill of the business from wrongful misappropriation by the former owner justifies an exception to the general rule. As phrased by the Utah Supreme Court, "Restrictive covenants are generally upheld by the courts where they are necessary for the protection of the business for the benefit of which the covenant was made and no greater restraint is imposed than is reasonably

necessary to secure such protection." Allen v. Rose Park Pharmacy, 237 P. 823, 826 (1951).

That the nature of this exception is based on the protection of "goodwill" evidenced by the Court's statement in Rose Park as follows:

"...when the individual responsible for creating the goodwill and the business to which it attaches, become separated, it is necessary to preserve that good will to the business by a covenant on the part of the individual that he will not compete in an area where his personal reputation will detach the old customers from the old business." Id., p. 827.

Construction and interpretation of the subject Covenant Not to Compete must therefore be based on the fundamental principles that (1) the Covenant exists to protect the goodwill and (2) the Covenant should not be given greater operation than is necessary to effect such protection.

POINT VI

UPON THE DEATH OF THE COVENANTOR, A COVENANT NOT TO COMPETE BECOMES UNENFORCEABLE SINCE THE RESTRAINT IS NO LONGER REASONABLY NECESSARY TO SECURE PROTECTION OF GOOD WILL.

It is well established that Covenants Not to Compete must be reasonable in geographical area and duration of time. With respect to this policy basis of protecting good will, it should be apparent that such restrictions in competition are unnecessary when the covenantor whose forbearance is the subject of the restrictive covenant is no longer alive. Obviously, had the covenantor died before selling the business, there would have been no need for a Covenant Not to Compete and therefore such a covenant would be invalid since it was not "reasonably necessary to secure such protection." Rose Park, supra. Under such circumstances

the heirs would have to sell the business based on its real assets, without compensation for a noncompetition agreement.

This same conclusion was reached in a comprehensive article entitled, "Enforceability of Covenant Against Competition Ancillary to Sale of Business, Practice, or Property, as Affected by Duration of Restriction" 45 ALR 2d 77. After stating the general rule that "a Covenant Not to Compete may extend over such period of time as is necessary to protect the interests of the purchaser or other Covenantee, but may not last longer," the annotation continues:

"It is submitted that several important conclusions may be logically drawn from this principle, although there may be no express authority therefore in the reported decisions. . . (2) The restraint cannot exceed the Covenantor's own life. This time limit is obviously set by nature." (Emphasis added.) Id. page 153.

Corbin phrases the same conclusion with regard to time limitations in such restrictive covenants as follows:

"One time limit is certainly set by nature and the law in all cases. The restraint cannot exceed the Promisor's (seller's) own life or the lives of those for whose forbearance he has contracted and who helped create the good will sold."

Corbin, Contracts, Section 1391, page 81.

Applying these rules of law to the present case, therefore, it is clear that at the inception of the contract, the law proscribes intent for a Covenant Not to Compete to extend beyond the life of the covenantor (seller). Since, in the present case, it was determined that neither party had any expectation of death, then no intent with respect to continuation of the Covenant Not to Compete can be held to have existed. However, it can be said that the law implied a condition on the covenant to make it valid. That condition was that at the death of the seller (Rudd)

the covenant would no longer be enforceable.

Since it has been shown that the Covenant Not to Compete was supported by its own consideration of forbearance from competition and that Mr. Park would not have purchased the business except that a covenant not to compete was added to the exchange of consideration, it must be assumed that the payments made under the agreement were intended for purchasing the continued forbearance of Rudd from competitive acts. This assumption is believed to be valid since contrary evidence was shown by Plaintiff that the parties had an intention to the contrary or that the consideration exchanged under the first two agreements for the sale and purchase was insufficient. The parties labelled the payments as consideration for noncompetition and the monthly amounts were extended over a five year period of noncompetition.

Therefore, when Hyman Rudd died, the terminating condition implied by every such covenant not to compete was fulfilled. The covenant was no longer enforceable and there was no longer a basis justifying continued payment by Rudd had been compensated for that period during which he complied with his part of the agreement. Since Parks could not enforce the provisions of noncompetition upon the heirs of Rudd, there was no obligation to make payments to the heirs under a terminated Covenant Not to Compete.

POINT VII

COVENANTS NOT TO COMPETE TERMINATE AT THE DEATH OF THE COVENANTOR BECAUSE SUCH COVENANTS ARE PERSONAL TO THE COVENANTOR, AND UNENFORCEABLE AGAINST HIS HEIRS.

In addition to the aforementioned basis for terminating restrictive covenants under the protection theory of good will, the courts have also viewed these covenants as personal to the seller or covenantor and therefore terminable at his death. The U. S. District Court of Wyoming was confronted with a case similar to the case at hand in Keller v. California Liquid Gas Corp., 363 F Supp 123, (1973), in which Judge Kerr specifically ruled that the payment obligation under a Covenant Not to Compete terminates at the death of the seller.

Simply stated, the Keller case arose based on the sale of a business by Plaintiff's decedent (Moncur) to Defendant (California Gas). As part of the sale, the parties executed an agreement in which Moncur promised not to compete for a period of ten years. In return, Defendant agreed to pay "the sum of One Hundred Thousand Dollars..." to be paid in ten annual installments. After Moncur died, Defendant paid two more installments (\$20,000.00) but discontinued payments thereafter. The heirs and executor of the Moncur estate sued in an effort to obtain the balance owing under the Covenant Not to Compete. The basis for terminating the Covenant Not to Compete at the Seller's death was summarized as follows:

"A Covenant Not to Compete, it has often been stated, is to be strictly construed and not be given effect beyond what is necessary to give the Covenantee the protection needed. Such Covenants Not to Compete are not favored at law and thus are strictly limited. They are not assignable by the Covenantor, nor can the Covenantee enforce them against the heirs of a deceased Covenantor. It is for such reasons that Covenants Not to Compete have been held to be, by a majority of the courts, of a personal nature." Id. page 126.

Continuing, the Court stated:

"As a personal Covenant made by the Sellers, it is clear that one not

a party to it cannot be enjoined or held liable under it. Just as clearly, such personal Covenants have been held to terminate at death." Id. page 128.

With respect to continued payments after death, the Court therefore held:

"...that the Covenant Not to Compete ceased upon the deaths of the Covenantors; that the Covenantee is entitled to the \$20,000.00 paid after the deaths of the Covenantors..." Keller, Id. page 129.

The similarities between Keller and the present case are striking. In words of Plaintiff's counsel, "it's almost four square...directly on the issue before the Court." (Tr. page 63, lines 1-2.) More significantly, the Court decided Keller on motions for summary judgment, stating, "The case at bar present some slight issues of fact, but none of a material nature, and in any, the ultimate legal result is clear." (Emphasis added) Id., page 126. In other words such agreements are subject to the effects of the law such as is stated in Corbin and the ALR citation previously quoted, to the effect that they do not take effect after the life of the Covenantor.

In Keller, it is interesting to note that the sales contract has the same appearance of entirety as that executed by Rudd and Parks. The Covenant Not to Compete was ancillary to other agreements effecting the sale of the business and totalled by itself "the sum of One Hundred Thousand Dollars (\$100,000.00) ...paid by buyer to seller in ten yearly installments...to be paid on October 1st of each succeeding year." Id., page 125. It is submitted by Defendant that such appearance of "entirety" will arise with any valid covenant not to compete in the absence of the requirement that the sales agreement and restrictive covenant be ancillary to each other.

In both Keller and the present case the deaths of the sellers occurred as a fortuitous event. In Keller, the seller was killed in an airplane crash only one year into the ten year period of performance. Similarly, Hyman Rudd died suddenly after only two years of performance under the Covenant Not to Compete. In both cases, death was not an expectation planned for in the transaction agreements. Also, both cases are brought by the heirs or estates of the deceased sellers, who were apparently the only parties contesting the effect of the agreement.

At trial, Plaintiff pointed to a distinguishing fact in the Keller case, noting that the heirs in that case actually competed with the buyers, who were making payments to the estate under the covenant not to compete. Plaintiff noted that in the present case the heirs had not been involved in competitive activities. The fact that the plaintiffs had "unclean hands" in the Keller case, however, was not considered relevant by the Court in voiding the agreement upon the death of the seller. Quoting from Fleckenstein Bros. v. Fleckenstein, 57 A. 1025 (1904), the Court emphasized the absence of a cause of action against the competing heirs of the seller, saying:

"The conduct of a wife or a son in destroying or appropriating a good will which a husband or father has sold may be morally reprehensible according to circumstances. A purchaser takes the risk... , that, after all, the covenant may prove to have little or no protective value..." Id., page 128.

With respect to the heirs, the Court continued:

"As a personal covenant made by the Sellers, it is clear that one not a party to it cannot be enjoined or be held liable under it. Just as clearly, such personal covenants have been held to terminate at death. In re International Match Corporation, 20 F. Supp 240 (D. C. N. Y. 1937); Jones v. Servel, Inc., 135 Ind. App 171, 186 N. E. 2d 689 (1962), 6 Corbin, Contracts, Section 1335 (1964)." Id.

As to the effects of termination, the Court stated:

"The covenant in issue is clear and unambiguous; it is of a personal nature; and it terminated upon the deaths of the covenantors. As stated by many, equity will not assist a party seeking to enforce a hard bargain." Id.

In concluding, Judge Kerr stated the practical reason why it is inappropriate to permit the heirs of a seller to enforce payment provisions under a covenant to compete. Responding to plaintiffs' request for specific performance, the court stated:

"Plaintiffs would ask the court to allow them to compete against defendant while still requiring payments under a covenant, which as shown, supra, has ceased to exist. The court cannot be a party to such an unconscionable bargain." Id.

It should be noted that it was not the particular plaintiffs with unclean hands that were the "unconscionable bargain"; but rather, it was the occurrence of a situation that would "allow them" (heirs) to compete against defendant while still requiring payments under a covenant, which as shown, supra, has ceased to exist.

Plaintiff is asking for the judicial approval of this same unconscionable bargain. Rudd's estate asks the Court to affirm a decision which allows the heirs to compete, while still requiring payments from defendant under a nonexistent covenant. That these heirs are or are not competing at the present is not the issue. The fact remains that at any point over the remainder of the contract period the heirs could use the thousands of dollars paid by defendant under the noncompetition agreement to establish a competing company. In such circumstances, Melville would be powerless to take any action against them.

Plaintiff would argue that such competition has not occurred and therefore that this argument is inapplicable. Defendant asserts, however, that equity

look at what can happen, as well as what has happened. Mr. Parks entered into an agreement with Mr. Rudd which he has fully performed. With the death of Rudd, there was a termination of the agreement. This Court should not now impose a new agreement for the benefit of heirs who had no role in creating the good will subject to the Covenant Not to Compete, nor any relation to the Covenant. In such circumstance, the heirs receive a benefit not bargained for and Parks assumes a liability which was not part of the agreement.

POINT VIII

THE COURT SHOULD RESOLVE THE INTERESTS OF THE RESPECTIVE PARTIES BY MAKING THE APPROPRIATE CONSTRUCTION OF THE FINAL AGREEMENTS OF THE PARTIES, WITHOUT REFERENCE TO EXTRANEOUS MATTERS.

Defendant submits that the parties reached an arms-length agreement as experienced businessmen. It must be assumed that the bargain reached was based on the mutual assent process, and that for the Court to attempt to adjust interests at this point would certainly be unfair to Parks whose willingness to purchase Rudd's business was based upon the specified terms of the respective three agreements.

It is acknowledged by all parties that the agreements for sale and purchase of the business assets have been fully performed and are not in issue. As to the Covenant Not to Compete, there has been shown no ambiguity which justifies going beyond the signed agreement. Since the only issue regarding this agreement is the effect of the death of Hyman Rudd on payments, and since the fact finding of the trial court showed no intent on the part of the parties which related to the occurrence of death, extraneous matters will not be useful to resolve this issue.

In attempting to extend the Covenant Not to Compete beyond its natural life based upon the life of the seller, Plaintiff would ask this Court to imply by the parties in a conventional "heirs clause" contained in the covenant. The clause states, "It is expressly understood that the stipulations aforesaid are to apply to and bind the heirs, executors, and administrators of the respective parties." Evidence with respect to the insertion of this clause is summarized as follows:

1. The parties to the agreement did not request such a clause (Tr. 98).
2. The attorney for Parks utilized a form book having the clause as part of a covenant not to compete, (Tr. 100).
3. The secretary for the attorney preparing the agreement inserted the clause as part of the boilerplate of the form book, (Tr. 100-101).
4. Neither party demonstrated any awareness of the clause, as was clear by the trial court: "I think his answer is clear. Lawyers draft these contracts and the clients sign them. They don't know why the provisions are in there or what they mean in many cases." (Tr. 27, lines 24-27).

This very fact pattern is what the Missouri Supreme Court was referring to in dealing with an "heirs clause" in a personal service contract. In considering the ambiguity that arises by the presence of such a paragraph in the agreement the Court stated:

"That paragraph is not ambiguous in the sense that its meaning is doubtful or uncertain or that it is equivocal..." Jones v. Joy Manufacturing Co., 381 SW 2d 860, (1964).

The Court went on to say that the application of such a paragraph to contract provisions not calling for personal services (i.e., survivable obligation of the Covenant Not to Compete) "would not be unusual and is clear enough." Conf

"In a contract for personal services, however, at least insofar as the

heirs are concerned, its inclusion is inappropriate." Id., page 863.

The Court went on to hold that no ambiguity existed based on the law that:

"The possibility of termination of a contract for distinctive personal services by the death of the party to render the services must be regarded as an inescapable concomitant of every such contract." (Emphasis added). Id., page 863.

Although the heirs clause does not relate to the "personal" covenants of the seller, it is recognized that there are obligations which can survive the death of the buyer. Since the buyer's obligation is only to pay money, it is generally recognized that the payment obligations continue after the buyer's death or also upon sale of the business and good will to a new buyer. It may well be for this reason that the heirs clause was placed in the form book as boilerplate. Certainly, there are substantial contract interests aside from the personal service aspects, which should be properly preserved through the death of the parties. Therefore, Defendant submits that no ambiguity exists regarding the subject Covenant Not to Compete.

Viewing the Covenant Not to Compete as a whole, it is apparent that the payment period of five years and the noncompetition period of five years were coordinated to provide the practical result of ensuring performance by Rudd in order to obtain the monthly payments due. This coordination of performance to payments further reinforces the independent meaning given to the Covenant by the parties.

Plaintiff indicates contrary intent by referring to the totality of consideration expressed in the covenant, in terms of "the sum of \$95,000.00." This, however, fails to suggest more than an expectation of the parties that such a total sum would

be paid over the life of the contract, assuming no change of conditions. Such language is commonly used, such as was referenced in Keller.

In Jones v. Servel, 186 NE 2d 689 (1962 Indiana)., the court dealt with effect of death in a covenant not to compete and was confronted with similar language. The forbearance from competition was "for a period of one year," the consideration in return was to pay a salary "at the rate of \$75,000.00 per annum, payable in equal monthly installments. The Covenantor died after 18 months. Since no services were rendered except those in connection with the Covenant Not to Compete, the estate sued for full payment contending complete performance of the Covenant Not to Compete by the death of the Covenantor and a waiver of other services. The court stated:

"If the personal service clause in the contract and the Covenant contained therein Not to Compete are personal service contracts in the sense that they terminate on death, the appellant would have no action regardless of the merits of his contention." Id. page 693.

The court went on to hold that Covenants Not to Compete are personal and terminate at death. The so-called "entirety" language was without effect.

POINT IX

THE "STRONG PROOF RULE" APPLIED BY FIRST, SECOND, FIFTH AND SIXTH U.S. CIRCUIT COURTS WITH RESPECT TO CHALLENGES OF ALLOCATIONS TO COVENANTS NOT TO COMPETE SHOULD APPLY TO PLAINTIFF'S CHALLENGE REGARDING SEVERABILITY VS. ENTIRETY AND OTHER ALLOCATION QUESTIONS.

It appears to Defendant that the primary effect of the trial court's holding is to impose a new allocation of consideration upon the parties--different than the \$95,000 agreed upon. This is considered improper in view of the fact that the issue was not established by any evidence making a contrary showing. If the

court had been willing to accept the allocation of the parties, then the Covenant Not to Compete, having terminated at death, would have been without effect thereafter.

Numerous cases have arisen in the Federal Courts where parties have contracted to sell a business, making allocation of consideration to a Covenant Not to Compete. As stated in 13 Fed Tax Coordinator 2d 28, 326A:

"The tax interests of buyer and seller of a business are conflicting, as far as consideration for the seller's agreement not to compete is concerned. The buyer wants deduction or rapid amortization of part of his purchase price. The seller prefers capital gain to ordinary income."

The burden of proof required of Plaintiff's challenging this allocation has been summarized as follows:

"In view of the conflicting tax interests of buyer and seller on this point, the courts will be inclined to accept a specific allocation set forth in a contract arrived at in an arm's length transaction. 264 F 2d 305, 334 F 2d 58, 208 F Supp 306, 457 F 2d 1022, 450 F 2d 959, 290 F 2d 501, 444 F 2d 557. The (challenging party) must carry a heavy burden of proof in upsetting such an allocation." (Emphasis Added.), Id., page 28328.

Many courts, including the First, Second, Fifth and Sixth Circuits and the Tax Court require that the Plaintiff produce "strong proof" in order to set aside such allocations between seller and buyer. Defendant respectfully urges that where both Hyman Rudd and Mel Parks knowingly agreed to the subject allocation, the same "strong proof rule" should be required of Plaintiff herein. This is even more appropriate in this case, since it is admitted that both parties knew that, "these were the only terms on which Mel Parks would buy."

In considering such reallocations of interests between buyer and seller, the U. S. Court of Claims, quoting an earlier case, stated:

"To permit a party to an agreement fixing an explicit amount for the covenant not to compete to attack that provision for tax purposes, absent proof of the type which would negate it in an action between the parties, would be in effect to grant, at the instance of a party, a unilateral reformation of the contract with resulting unjust enrichment. Commissioner v. Danielson, supra, at 775 of 378 F2d." Dakan v. U. S., 492 F2d 1192 (1974).

In other words, it is highly doubtful that Hyman Rudd would have been to bring a successful suit reallocating consideration from the Covenant Not to Compete to the purchase agreements of the transaction. The fact is that he was satisfied with the arrangement, despite its adverse tax consequences, because he wanted to sell the business. Nevertheless, the estate now seeks such a reallocation in order to avoid the termination effects upon payments due after the death of

Defendant asserts that the heirs should not succeed where their interests would have failed. The parties struck their bargain and were satisfied. They should expect nothing different.

POINT X

THE COURT SHOULD NOT UPHOLD THE SUBJECT TRIAL COURT HOLDING WITHOUT A REEVALUATION OF THE AMOUNT ASSIGNABLE TO COVENANT NOT TO COMPETE.

Defendant asserts that the state of the law regarding obligations of parties under a covenant not to compete are clear. The death of the covenantor terminates such payments. Since the evidence clearly shows at least some independent value to the covenant, at least some allocation supported by the covenant consideration should be properly forfeited because of Rudd's death. Such a forfeiture cannot be assessed upon evaluation of the actual value attributable to the Covenant Not to Compete. Defendant would suggest, therefore, that upholding the ruling of the

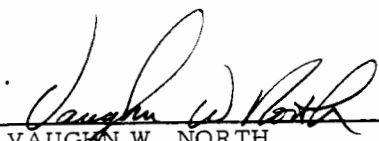
trial court requires remand for determination of a proper allocation of consideration to the subject covenant.

As difficult as such a reassessment might be, the alternative of requiring full payment by Parks is contrary to the law and clearly inequitable. It would force Parks to make a purchase of a business under terms which the evidence shows that he was unwilling to make.

CONCLUSION

There is no question that the parties intended that a Covenant Not to Compete be part of the sales transaction between Hyman Rudd and Mel Parks. The substantial importance of the Covenant Not to Compete as a basis of the bargain between the parties is evident from the fact that there would have been no transaction without the Covenant Not to Compete. Both Mel Parks and Hyman Rudd accepted the provisions of the Agreements without contention and have fully performed their obligation. Plaintiff's evidence fails to meet the burden of proof to show contrary intent. The law is clear regarding termination of the Covenant Not to Compete with the death of the Covenantor--based both on personal service contract theory and restraint of trade considerations. These legal bases, along with the clear support of case law, require a ruling consistent therewith. Defendant respectfully submits that such ruling can be effected with the appropriate dismissal of Plaintiff's Complaint and Cause of Action, with prejudice.

DATED this 4th day of April, 1978.



VAUGHN W. NORTH
Attorney for Defendant-Appellant

CERTIFICATE OF MAILING

I hereby certify that a copy of the Defendant-Appellant's Brief of Appeal from the Judgment of the Third Judicial District Court, Case No. 15491 was mailed to BERNARD L. ROSE, Attorney for Plaintiff-Respondent, 920 Boston Building, Salt Lake City, Utah 84111, this 5th day of April, 1978.

VAUGHN W. NORTH

Vaughn W. North
Signature

April 5, 1978
Date